Compliments of The First National Bank in Minneapolis, Minn.
Correspondent of The National City Bank of New York

1812

THE NATIONAL CITY BANK OF NEW YORK

1928

Economic Conditions
Governmental Finance
United States Securities

New York, December, 1928

Capital Readjustment, The National City Bank of New York

THE Board of Directors of The National City Bank of New York has voted to recommend to the shareholders that at the Annual Meeting to be held on January 8, 1929, the shareholders take action to increase the capital stock of the Bank from $90,000,000, as at present, to $100,000,000, and by the issuance of such additional stock to provide $50,000,000, of which $10,000,000 shall be used to pay in the additional capital, and $35,000,000 shall be added to the surplus, and the remaining $5,000,000 shall be applied to increasing the capital stock of The National City Company so as to preserve the present ratio between the capital stock of the Bank and the capital stock of the Company.

After these increases, the capital stock of the Bank will be $100,000,000, and the surplus $100,000,000, with undivided profits in excess of $11,000,000, while the capital stock of The National City Company will be $50,000,000, and its surplus $50,000,000, with substantial undivided profits.

The Board of Directors has also voted to recommend that the shareholders take action to change the par value of the shares of the capital stock of the Bank from $100 to $20 each, which will result in giving each shareholder five shares for every share he now holds.

In his letter to the stockholders, dated November 27, the President indicated the purposes of the proposed increase in capitalization as follows:

> This rounding out of our capital structures is deemed desirable in view of the continuing expansion of our many institutional activities at home and abroad.
>
> The Board is of the opinion that this increase in the number of shares of stock outstanding and the proportionately lower market value per share will lead to a wider distribution and make the stock by reason of greater price stability a more desirable investment and one within the reach of the smaller investor. This action is directly in accord with the institutional policy of recent years to increase the number of popular contacts and through service and proprietary interest to make such contacts continuingly effective.

Following are the dates of previous increases in the capital of The National City Bank of New York since 1900, and the amounts of the increases:

1900	$ 1,000,000	to	$10,000,000
1902	10,000,000	"	25,000,000
1920	25,000,000	"	40,000,000
1925	40,000,000	"	50,000,000
1927	50,000,000	"	75,000,000
1928	75,000,000	"	90,000,000

Election Results

The Presidential campaign which has just come to a close with the election of Mr. Hoover by a great majority has been notable in many respects, not the least of which has been the absence of the violent and bitter attacks upon the existing economic order, and what is popularly spoken of as Wall Street, that have marked many previous campaigns and were particularly characteristic of the third party movement of 1924. The past four years of steadily maintained prosperity, in which more and more of our citizens are finding their share, have done much to create a contented nation, and to render the people less susceptible to the preaching of radical doctrine.

In the two candidates the country has been fortunate in having men of forward-looking yet conservative principles and of demonstrated zeal and capacity in the public service. They have held the confidence of the business interests large and small, and have made their appeal through a sober-minded discussion of the issues upon which the campaign was fought.

Secure in this knowledge that neither candidate was an advocate of sudden or disturbing changes in the policies of Government, business has been able to go ahead unhampered by the uncertainties often prevalent during an election year, and accomplish the full recovery which has once more established a new high water mark on the record of American prosperity.

While various explanations may be advanced to account for the victory of the Republican party at the polls, it is doubtful if any single factor was more potent than this background of prosperity through the past eight years of Republican rule. Never before has a

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nation made such progress in the accumulation of wealth in so short a time as has the United States since 1921, and regardless of the extent to which this may or may not have been due to the political party in power, it is not surprising that the people would not wish a change so long as this happy condition continues.

The election of Mr. Hoover brings to the Presidency a man of broad vision, practical judgment, and large experience in public affairs, both national and international in scope. Qualities such as these will be much needed in the solution of the many difficult problems that will face his administration. That the country as a whole feels confident of the continuance of its present prosperity under his leadership is impressively shown in the prompt and vigorous response of the security markets to his election.

General Business Conditions

The general business situation continues satisfactory at this writing. What little hesitancy had been felt pending the outcome of the election has been dispelled, and the country now looks forward to the Christmas trade with every assurance of a record-breaking volume.

Some industries, notably iron and steel and automobile manufacturing, have shown a seasonal recession in November, but generally speaking business is maintaining a comfortable lead over last year. The diagram at the foot of the page comparing the trend in the three key industries — iron and steel, automobile production, and building — by months of this year and last year indicates the decisive character of the recovery which has taken place in these lines, and experience has demonstrated time and again that as these industries go so goes business in general.

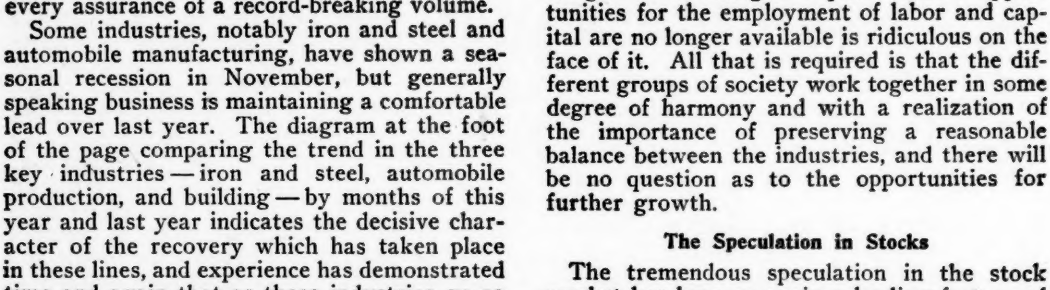
It is true that numerous commentators continue to find reason for emphasizing the irregularities that still exist, and undoubtedly there are a good many lines having a hard time of it despite the more satisfactory condition of the majority. It is unfortunate that this has to be the case, but prosperity is never equally distributed through all lines of industry. Granting that room for considerable improvement exists in numerous individual lines, it is difficult to see how business generally could be expected to be much better, and there is reason to fear that a good many persons are falling victim once more to the rather common mistake of not recognizing good business when they have it.

Announcement such as that of the Pennsylvania Railroad of its intention to spend $100,000,000 over the next seven or eight years in the electrification of its entire line between New York and Wilmington, followed shortly afterwards by a similar announcement by the Reading Railroad of its decision to spend $20,000,000 during the next three years in the electrification of most of its trackage within the Philadelphia metropolitan district, later to be extended over the entire system, should be a good antidote to the gloomy forebodings of pessimists who seem to fear that the country is in danger of exhausting its possibilities for further expansion and that unless we stop and wait a while until the country "catches up" there is not going to be enough work to do. That individual industries can, and often do, over-expand to their cost is admittedly true, but the proposition that this country is in danger of reaching the point where opportunities for the employment of labor and capital are no longer available is ridiculous on the face of it. All that is required is that the different groups of society work together in some degree of harmony and with a realization of the importance of preserving a reasonable balance between the industries, and there will be no question as to the opportunities for further growth.

The Speculation in Stocks

The tremendous speculation in the stock market has become again a leading feature of the situation and one which inevitably raises the question as to what is in store when the movement ends, as end it must some day. With a wider public participation in the market than ever before, with the facilities of the Stock Exchange already overtaxed by the volume of trading, and with a huge volume of funds loaned in the market by non-banking interests who assume no responsibility for the maintenance of an orderly market and whose

(Latest 1928 Plotting—October)



sole interest in the event of trouble might be to regain possession of their funds, it must be admitted that the situation has unpleasant possibilities.

At the same time there seems little likelihood of business becoming seriously involved in any market decline. Undoubtedly a severe break in securities would throw a chill over the situation, but business appears too sound fundamentally to be more than temporarily thrown off balance by any such development. With the present firmness of money largely associated with the activity of the stock market, any abatement of activity in that quarter would probably be followed rather quickly by an easing of money conditions which would be a strong influence in the support of business.

Indeed, there is ample justification for the opinion that a reaction in the stock market, providing it were not too severe, would be the best thing that could happen for business, inasmuch as it would lessen the demand for funds in that quarter, which is keeping money rates up and which sooner or later, it is to be feared, may affect business unfavorably.

Industry and Trade

Reflecting the favorable trend of industry, employment in manufacturing industries in the Fall, according to the National Industrial Conference Board, reached the highest level since April 1927, while average weekly earnings of workers were the highest since 1920, a year of inflation. The continuation of this high level of wage earnings in the face of a much lower level of commodity prices than prevailed in 1920 is measure both of the increased efficiency of industry, which has made possible a lowering of production costs in many lines without wage cutting, and of the betterment in the economic condition of the workers due to the increased purchasing power of their wages.

The consumption of electrical power in industry continues to break all records for the season, and railway loadings of revenue freight are running higher than in the corresponding period of any previous year save 1926.

Of the three industries—iron and steel, automobiles, and building construction, whose activity has been an outstanding feature of 1928,—the first established a new high production record of 4,647,891 ingots in October, an increase of 40% over the output of October last year. Automobile production amounting to 398,818 vehicles gained 81.5% over October last year and was the largest for any October on record with the exception of October, 1925. As for building, despite the unfavorable conditions in the real estate investment market, contracts awarded for all types of construction during the month exceeded those of any October bar none, with every major district of the country showing an increase over last year with the sole exception of the Central West.

In both the steel and automobile industries the present rate of activity represents a decrease from the peak levels of some weeks ago. From all indications, however, the year-end decrease in both these lines is going to be less than usual, and a prompt recovery of operations is confidently predicted after the first of the year.

Non-ferrous metals continue active and firm in price, with copper the principal feature. Despite increasing production, heavy shipments have made a further reduction in the already meagre stocks of refined metal, the reserve supplies standing at the end of October at 45,648 tons, a new low since the collection of these statistics was begun in 1919. With large electrification projects in prospect, a constant increase in the use of electrical equipment, and a rapid development in new uses for copper in many other directions, the outlook for the copper industry is the best in years. At the present price of 16 cents a pound for copper the leading companies are enjoying substantially increased earnings which have already led in a number of instances to dividend resumptions and increases. During October copper mining wages were advanced 10%.

Textiles Pick Up

The gain noted a month ago in textiles has continued, affording hope for the further recovery of this important industry. One of the most encouraging symptoms has been the definite improvement in the cotton spinning branch, the October mill consumption of raw cotton amounting to 618,788 bales, the largest for the month on record, and a big increase since the low point of last July, when 438,743 bales was consumed. Measured in terms of spindle activity, the month's statistics showed the industry to be operating at the rate of 103.9% of single shift capacity, compared with 90.6% for September, with New England as well as southern mills sharing in the increased business. From Manchester, N. H., for example, comes word that employment at the big Amoskeag plant is the largest since 1922, with some departments running on night shifts.

What is even more indicative of improvement in the industry is the fact that, despite the large production for October, sales of cotton goods, as reported by the Association of Cotton Textile Merchants of New York, were still larger, and that for the first time in months the unfilled orders were in excess of stocks on hand, totalling at the end of the month 98,000,00 yards above the yardage on hand.

With domestic consumption of cotton showing such a marked increase, with reports from

textile centers abroad also indicating a better movement, and with exports for the first three months of the crop season 10 per cent above those for the same period of last year, it now appears reasonably certain that fears for increased carry-over of raw cotton at the end of the crop year were baseless, and that instead of an increase there is now the possibility of a decrease, a strengthening of the statistical position which has been reflected in an advance in the price of about a cent a pound to 20¾ cents.

Recent betterment in cotton goods has extended also into woolen goods, and the American Woolen and other leading mills are reported to have taken large orders in recent weeks. That stocks of woolen goods have been low has been known for some time, and the suggestion is now made that hand-to-mouth buying policies have over-reached themselves. According to press dispatches from Boston, operations of the American Woolen Company have been increased to around 70% of capacity, as compared with less than 40% at the low level earlier in the year, and generally the outlook in the industry is regarded more hopefully than in some time.

Overproduction in Print Paper

The print paper industry, on the other hand, has been so demoralized by excessive production that the provincial governments of Ontario and Quebec, which have a direct interest in the situation on account of their ownership of timber lands, as well as on other accounts, have practically compelled the manufacturers in those provinces to reach an agreement for the regulation of production and prices. They were in a position to exercise this authority by reason of their control of the raw material, and the premier of Quebec, in commenting upon the agreement, is quoted as saying:

> We promised them, Mr. Ferguson and myself, the full co-operation of the governments of Ontario and Quebec to see that every party to that contract would live up to it.

Incidentally it may be mentioned that the Canadian output of print paper is mainly sold in the United States. The paper situation, however, shows not only the intensity of competition, but that control over prices must be exercised through control over production. The premier of Quebec in his statement attributed the demoralization of the paper industry to the competition engendered by the high prices prevailing in the years immediately following the war.

Money and Banking

Money has shown some signs of easing in the past month, although rates upon commercial loans are unchanged and the renewal rate on call money was below 6½% on but five days. The most tangible evidence of a lessening of commercial demands was in the decline of loans in this classification and rise of loans on stocks and bonds, as shown by the weekly figures of reporting member banks. The former at the close of the month were down about $50,000,000 from the average in October, and are lower than in any week since September. This is in keeping with the usual tendency at this season of the year. Loans on stocks and bonds are up about $250,000,000 from the average in the first half of October, and about even with the record figures before the slump last June. It is noteworthy that although brokers' loans in the aggregate are about $600,000,000 above June figures, member bank loans of the class are no higher than at that time.

Investments of reporting member banks have declined about $20,000,000 during the month, $42,000,000 since October 3, and $300,000,000 since June 1st, which signifies liquidation on account of high interest rates in the short market.

The increase of Reserve credit in the market throughout the Fall has been all accomplished through the purchase of acceptances, arising in the greater part from foreign trade. The volume of this paper has been greater than ever before, due probably to a growing appreciation of the fact that under the fostering care of the Reserve authorities this has been the cheapest form of financing. The purchasing rate at the Reserve bank has been 4½%, against the regular discount rate of 5%, and the holdings of this class of paper by the Reserve banks increased from $184,000,000 at the end of August to $484,000,000 on November 21, while in the same period rediscounts and advances declined from $1,039,000,000 to $800,000,000.

These purchases have put $300,000,000 of Reserve credit into the market since August, a part of which has been used by member banks to reduce their rediscounts, a part to obtain the larger supplies of currency always needed at this time of year, and the remainder has served as the basis of many times the corresponding amount of member bank credit. This form of paper enables a member bank to obtain Reserve credit without giving its own direct obligation as in the case of a rediscount, and ordinarily liquidation occurs in due time without any action on the part of the accepting bank.

In the past month the Reserve authorities have tightened up on the purchase of acceptances, by restricting purchases to issues which have run a part of their terms, instead of taking fresh issues, as they had been doing. This means that they must be carried for a time, or sold on the market, before being offered at the Reserve bank, a condition which

in view of current market conditions may mean that rates will have to be higher. Anyway, the change in the Reserve attitude is accepted as signifying that credit will flow less freely in that quarter, and that as the present holdings of bills run off the volume in the Reserve banks will run down.

Brokers' Loans

Brokers' loans, as reported by the Federal Reserve bank of New York, reached their low point after the June slump on July 25, when they totalled $4,183,000,000, but did not start on the recent rise which up to date has been continuous until the week ended August 29. We give the totals for the member banks of New York City with the usual division into three groups, for June 6, August 29 and November 21.

	Nov. 21	Aug. 29	June 6
For own account	$1,126,000,000	$ 793,000,000	$1,167,000,000
For out of town banks	1,751,000,000	1,535,000,000	1,642,000,000
For others	2,280,000,000	1,907,000,000	1,754,000,000
Total	$5,157,000,000	$4,235,000,000	$4,563,000,000

The aggregate of brokers' loans as reported by the Stock Exchange was $5,879,000,000 on November 1, $5,051,000,000 on September 1, and $5,274,000,000 on June 1.

Source of Expanding Loans

No little speculation is current as to the source of the increase, in view of the attitude of the Reserve authorities toward this class of loans and the comparatively small gold imports. We have referred at different times to the tremendous potentiality under our banking system of additions to the reserves of the member and non-member banks, either by importations of gold or grants of Reserve credit.

It has been commonly reckoned, for convenience, that member bank credit may be expanded upon the basis of reserve credit in the ratio of 10 for 1, but these figures are much below the total expansion of bank credit in relation to Reserve credit in recent years. One explanation for the rising ratio is found in the growth of time deposits.

The Federal Reserve act requires that in what are known as Central Reserve cities, which are only two, New York and Chicago, the reserve shall be thirteen per cent on demand deposits, in what are known as Reserve cities, comprising sixty-five cities of leading importance, ten per cent, and for all other member banks seven per cent on demand deposits. For time deposits, on not less than thirty days' notice, the required reserve is three per cent for all banks.

It is of importance that the proportion of time deposits in total deposits has been steadily increasing. On December 29, 1922, it was twenty-eight per cent for all member banks and for June 30, 1928 it was thirty-seven per cent. These low reserve requirements on time deposits lower the average requirements on all deposits and thus increase the credit expansion which may be had on the gold reserve.

Governor Roy A. Young, of the Federal Reserve Board, in an address before the American Bankers' Association a few weeks ago, stated that on an average for $100 of deposits carried by a member bank a Reserve bank receives $7.50. That is approximately 13 to 1, and means that one additional dollar of reserve will support $13 of new credit, or $7,500,000 of new gold will support $100,000,000 of new credit.

In the first several years of this inflow since 1920 a considerable part of the new supplies was used to pay off loans at the Reserve banks, and the increase of credit outstanding was comparatively small, but in the five years from June 28, 1922 to June 30, 1927, with an increase of $800,000,000 in our gold stock, total loans and investments of all banks, member and non-member, increased by $17,000,000,000 or a credit expansion of more than 20 to 1.

In view of this record no mystery attaches to the fact that the stock market has been able to get more money, particularly when willing to pay interest rates ruling far above what are ordinary. At the above rate of expansion $100,000,000 of new Reserve credit might be made the basis for over $2,000,000,000 of other bank credit. The stock market finds protection in the fact that the Reserve banks cannot make money tight for one purpose without affecting rates for all purposes. It is practically impossible to pour credit into the general business pool without having some of it pass into the speculative pool. A great many individuals do business in both pools. Moreover, credit obtained for an approved purpose goes on circulating after it has been used for that purpose, until the loan is paid off.

It never was supposed by well informed persons that the supply of credit for brokers' loans could be peremptorily shut off.

There is elasticity in the use of credit in all quarters, particularly over limited periods. Nearly every locality can practice economy in the use of credit for a time, and with money lending in Wall Street at 6, 7 and 7½ per cent interest there has been a strong inducement to do so. Banks throughout the country have had an inducement to restrict or discourage home borrowings and corporations to trim or postpone expenditures for a time. Savings, profits and other free funds, which normally would be going into permanent investments, are to some extent, attracted to the stock market for investment or loan. Bond flotations have fallen off, and the banks, which have been

steadily accumulating bonds since 1922, have turned sellers this year, to set free funds to meet the decline of deposits and for use in the short term market. Credits have been transferred here from other countries in various ways, attracted by the high rates, and part of the gold which went abroad last year has been coming back. Nevertheless, these modifying influences do not nullify the fundamental change, which has occurred in the past year. This country is on a gold basis, and gold is required in increasing amounts if bank credits are to continue expanding, although it is true that we make a little gold go a long way. The great period of gold accumulation has run its course, and there is no escape from the significance of this fact. Bank credit will not be available in increasing amounts as when gold was coming in at the rate of several hundred millions per year. We may get more gold from time to time, but we may lose as much as or more than we get, and we will have to maintain high interest rates in order to get or keep it.

The Bond Market

The tendency during most of November towards somewhat easier credit conditions naturally had its effect upon the bond market. Although most groups have been inclined toward firmness and greater activity since the low point of the summer was passed, few showed any appreciable price improvement until recent weeks. Prices seem finally to have resumed their upward trend. Whether or not this improvement will continue will depend on money conditions after the turn of the year. There is every indication that first of the year interest and dividend disbursements, which promise a record, will seek early reinvestment in the security markets. Such a movement would of course have a favorable effect upon the level of bond prices.

There are several important sources through which further bond purchasing power promises to develop. In the first place, the respite in bond-buying during recent months, when the stock market held forth such unusual profit opportunities, has caused a considerable accumulation of investment funds which ultimately must seek employment. The increasing inquiry among private investors who have been temporarily out of the bond market would indicate that resumption of such buying may be looked for before long. Ranking second in importance to the private investors are the great investing interests such as life insurance companies, savings banks, estates and investment trusts. The month-to-month volume of bonds absorbed by such buyers is subject to less fluctuation than that of private buyers because these buyers are concerned primarily with keeping their earning assets always at work. Another potential source of funds is the call money market. During this recent period of high call rates a large volume of non-banking funds has been diverted from securities to the collateral loan markets. Under easier money conditions a fair portion of these funds would have gone directly into investment channels. Should call money rates adjust themselves to lower levels, the flow of such funds to the security markets may logically be looked for. Finally, the number of investors in this country is constantly growing, and this must lead to an eventual increase in the demand for bonds. Investors are gradually going to learn, through experience or otherwise, that they are always in a better position in the long run by having a fair portion of their investment funds in sound bonds.

United States Government Bonds

In line with the tendency toward higher prices in the whole high grade bond list, United States Government issues moved ahead slightly during the month. Prices are again well above the low levels established during the summer, although volume of trading on the exchange still continues in somewhat diminished volume. Improvement in prices, however, has been far from uniform as is evident from the table below showing the current position of active Government issues as compared with high and low prices for the year to date. Figures after the decimal point in the quotations represent thirty-seconds of a point.

	1928 Range		Market
	High	Low	Nov. 27
Liberty 3½s 1932-47	101.26	98.9	99.22
Liberty 1st 4¼s 1932-47	103.15	100.	100.26
Liberty 4th 4¼s 1933-38	104.	100.9	100.28
Treasury 4s 1944-54	111.12	104.26	107.10
Treasury 3¾s 1946-56	108.10	102.8	104.10
Treasury 3⅜s 1940-43	99.21	98.	99.
Treasury 3⅜s 1943-47	103.10	98.9	99.8

Municipals Firmer

A steady recovery from the extreme inactivity and price slump of the summer months has been the outstanding feature of the municipal market during the fall. Although private investors have been pretty much out of the market until recent weeks, the institutional demand has been sufficient to absorb the available supply of new offerings and, as a result, the technical position has been unimpaired. The increasing demand has found many dealers with insufficient stocks and bidding for the more important new issues has been more competitive than for some time. Winning bids as a rule have averaged slightly higher than the level at which comparable offerings were bought a month or two ago.

The underlying strength of the current market is perhaps best demonstrated by the readiness with which substantial new issues are

being absorbed. The $55,000,000 City of New York 4¼ per cent Corporate stock and serial bonds publicly offered to yield around 4.15 per cent were actively bought and at this writing a relatively small portion of the issue remains in the hands of dealers. The demand for the bonds came from widely scattered sources. Similarly, sales of $10,000,000 Chicago Sanitary District bonds are progressing satisfactorily with a fair portion of the offering already placed with investors and institutional buyers. The new $19,000,000 Detroit issue has been moving out in volume although sales have been somewhat slower. Although the volume of new offerings recently has shown a substantial increase and during the week in which the $55,000,000 New York issue appeared made a record for the year, the visible supply of new financing now in prospect is not sufficiently large to cause any apprehension. The technical position of the municipal market appears sounder than it has been for some time and the absorptive capacity of the market is apparently more than adequate to meet any early demands which may be placed upon it.

Spectacular Gains in Convertibles

Convertible issues continued to dominate the bond market during the month, several such issues scoring spectacular gains in response to the up-swing in share markets. The copper issues were again in the lead with Andes 7s reaching 241 and Anaconda 7s, 185. These figures represent a 120 point gain for Andes from the low for the year and 74 points for Anaconda. Barnsdall 6s with warrants were again active but at levels somewhat below their high. Liquid Carbonic convertible 6s sold at 205. Julius Kayser convertible 5½s rose to 135½, as compared with a low for the year of 105¼. Among the foreign convertibles Fiat Motor Company 7s and Pirelli 7s continue in the lead. Activity in Fiat bonds has been helped by the expectation that American shares of this company will soon be offered in the United States, and eventually listed. Issuance of such American shares would have the immediate effect of broadening the market for Fiat stock and would furthermore make the holder of Fiat warrants finally independent of the Milan Stock Exchange.

The Depressed Industries

Inasmuch as one political party in the recent campaign stressed the existing state of prosperity, it was natural that the other should emphasize the existence of depressed industries. Even the party which affirmed general prosperity was cautious about taking issue with complaints arising from particular industries. It is the usual practice in such instances to hear without controversy the aggrieved party's statement and promise that everything possible shall be done in the premises.

Agriculture held the first place among the depressed industries, on account of its economic importance in all parts of the country, its voting strength and the long agitation for legislation in its behalf.

The essence of the agitation was that agriculture was not getting fair treatment in comparison with the other industries, that it suffered from discrimination, and that something must be done to establish it upon a plane of "equality."

The textile industry and the bituminous coal industry also figured in the campaign as depressed industries, and, judging by election results, the textile workers were more deeply sensible of the depression under which they had been suffering than were the farmers. The farming States that were supposed to be in revolt against the "prosperity party" all turned up in its column with great majorities, while in Massachusetts the centers of the textile industries apparently resented the prosperity talk so bitterly that they placed the State in the opposition column for the first time in forty years.

The textile industry in New England although protected to some extent against foreign competition, has been suffering from the very same ills which have affected agriculture, and taken as a whole is more depressed. Furthermore, it has reached the stage of turning to Washington for relief. A conference of the industry with the entire Massachusetts delegation in Congress was held at New Bedford last week, to consider what might be done. Among the addresses made at the conference was one by Mr. Ward Thoron, Treasurer of the Merrimack Manufacturing Company, one of the important corporations of the cotton goods industry, which should be interesting reading for all who think agriculture has been the only industry suffering from depression. We give an extract which graphically describes existing conditions, and incidentally shows the fallacy of the theory that Manufacture has an advantage over Agriculture in that it can avoid losses by suspending operations.

The condition of the textile industry is in certain respects like that of agriculture. Possibly we need some McNary-Haugen bill, without its mechanics, to take care of our exportable surplus; something that will force the domestic consumer to pay us a decent price for our products, and in turn enable us to pay our operatives a decent wage for their labor.

The cotton textile machinery of the country (gauged by the spindles in place) is running, in the aggregate, something less than one shift, and yet it produces more than the country is ready to consume, when its product is forced on the market as fast as it is produced. This capacity to produce can be increased by longer hours and by running two shifts.

Another element of the problem is that in an industry scattered so widely the varying conditions under which it is conducted prevent any uniformity in operating costs. This lack of uniformity in cost of production is further accentuated by the use of a highly speculative basic raw material which makes the final cost of the product of individual mills still more irregular. In a contracting market, or rather in a market unprepared to expand to the productive capacity of the mills, these elements gradually force prices below the costs of many of the mills.

The logical outcome of such a situation should be that the higher cost mills would stop manufacturing as soon as prices fell to a point which showed no profit in their operations, and then through this closing down of higher cost mills the relation of demand to supply would adjust itself.

Unfortunately in practice it does not work out this way, owing to the fact that, for a time at least, it is less expensive to operate at a loss than to close down altogether, and owing to the further fact that the fuller you operate the lower your costs will be, so that the situation of falling prices, instead of acting as a check, acts as a stimulus to the losing mill to produce more than ever. Consequently prices are slaughtered.

With these conditions of overcapacity to produce for an insufficient market, unlimited competition is unsound, and, if the industry is to survive as a steady outlet for the employment of labor, it should give way to some form of co-operation.

That this is a truthful as well as effective statement of general conditions in the cotton goods industry cannot be questioned, but it is not at all clear that anything can be done at Washington to help the situation. The laws of this country against combinations in restraint of trade are not solely responsible for the ills of excessive competition. This is evident from the fact that the same conditions prevail in England, where there are practically no obstacles to trade agreements. Repeated efforts have been made there to unite the cotton goods industry in arrangements for the regulation of running time and the limitation of price-cutting, but all have failed, not from fears of legal prosecution, but from inability to secure united action. In 1926 a new trade organization was formed, to which was voluntarily given greater powers than ever had been exercised before, including authority to assess penalties for violations of the agreement. Moreover, the association actually exercised this authority to the extent of imposing upon one member a fine of £300, or about $1,500. The association was abandoned in 1927, because only about 75 per cent of the productive capacity could be induced to join it.

Price agreements, except among farmers, are forbidden in this country, but they seldom accomplish their purpose anywhere, for the fundamental reason that it is seldom possible to harmonize the interests and ambitions of all the parties concerned. All competitors are not operating under the same conditions, and those who are confident of their ability to survive and grow are not disposed to limit their possibilities by agreements with rivals whom they do not fear. Among equals a truce is possible, but conditions are always changing, new competitors are always developing, and in the long run the contestants who have the best of economic conditions will choose to make the most of that advantage.

The State of Agriculture

It is improbable that any serious opposition will be offered to the passage of the legislation for farm relief which was proposed in the Republican platform, and by President-elect Hoover during the campaign. The promise has been made, and even those who doubt the efficacy of any legislation upon the subject will generally agree that the pledge must be redeemed. There is still room to question how large a proportion of the farming population actually has been interested in the agitation for relief, or has faith in any of the various measures proposed, but undoubtedly a widespread feeling exists that some measure of relief should be given a trial. The chief objection to legislation in deference to such sentiment is that if it fails in its purpose the failure probably will not be accepted as proof of the fundamental fallacy in the plan, but to alleged deficiencies which call for further legislation of a like character.

There is much evidence to support the belief that agriculture is undergoing changes of very great importance, to which the leaders in the farm relief movement do not attach sufficient importance. The opening of the prairie country of the middle west about seventy-five years ago led the way to a development of horse-drawn machinery, which resulted in its general substitution for hand tools on the farms, with a great lowering of production costs. Now another development, of perhaps like importance, is under way through the introduction of the tractor and tractor-drawn machinery.

The Department of Agriculture has estimated that since 1920, disregarding births and deaths, the farm population has diminished by about 4,000,000 persons. The advocates of farm relief have referred to this movement as evidence of the need for legislation, but the crops have been increasing in volume instead of diminishing, and the complaints of low prices must be accepted as evidence that the farm population is still ample. An explanation of this increasing capacity of the farms appears in the existing state of activity in the farm implement industry. In 1921 this was one of the most depressed industries in the country, and the outlook for the future was very unpromising, but that situation is entirely changed, and the change is due to the introduction of motor-drawn machinery.

The industry has rehabilitated itself and promises to rehabilitate agriculture, or that section of it which takes advantage of the new implements. Stocks of agricultural implement companies are among those having made the most sensational advances in the past five years on the New York Stock Exchange.

Among the notable instances are International Harvester common, from under 70 to 380, and Case Threshing Machine Company from 15 to 500. The rise of Case is attributed largely to the "combine" which it has had on the market for several years.

A recent book on this subject to which we have referred,* by Professors Mead and Ostrolenk, gives the following table to illustrate the importance of the tractor and new machines adapted to it:

One man, two horses, 12 inch walking plow, can plow 1.6 acres per day.
One man, one tractor, 3 bottom gang plow, can plow 8 to 10 acres per day.
One man, 4 horses, 7 foot binder, can harvest 15 acres of wheat per day.
One man, tractor, 8 foot binder, can harvest 25 acres of wheat per day.
One man, tractor, 10 foot binder, can harvest 35 acres of wheat per day.

The combined harvester and thresher is an outstanding example of the new machinery. The once important annual movement of harvest hands into the wheat belt of the Southwest is practically a thing of the past. Even the crop-moving demand for money, which used to disturb the financial centers, is no more, partly because the expenditure of cash upon the harvest has been so largely reduced. Professor Boss, Professor of Agricultural Engineering in the Minnesota State College of Agriculture, University of Minnesota, presiding at a meeting of the American Society of Agricultural Engineers last August, referring to a statement to the effect that the "combine" might not be a practical machine in Minnesota, on account of climatic conditions, said that if this proved to be true it might be necessary for Minnesota to give up grain-raising on account of competition with the states where it could be used. Latest reports show that 21,000 "combines" have been sold in the season of 1928, an increase of 61 per cent over sales in 1927.

The one-row, horse-drawn cultivator has been the standard machine for corn cultivation for more than forty years, but in 1928 a three-row cultivator is a demonstrated success, enabling one man with a tractor to cultivate thirty acres of corn in a day. A three-row corn-planter and four-row corn-harvester also are on the market.

Some one has calculated that with the two-horse machinery in common use, 40 hours of man labor per acre is required to produce a corn crop, but with the latest type of power-drawn equipment, a fine crop of corn has been produced at Iowa State College with 3.83 hours of man labor per acre.

The following paragraphs are from an address delivered before the American Society of Agricultural Engineers, at its meeting in August, 1928, by Professor E. A. Stewart, late of the State Agricultural College, University of Minnesota:*

The large variety of agricultural tools now in use, with specialized equipment for each kind of crop and for use with mechanical power, such as corn planters, potato diggers, corn harvesters, gang plows, hay-loaders, combine harvesters, etc., are a development of the present generation; and modern power farming, with gas tractors, trucks, electricity, etc., is now only a baby in swaddling clothes, an infant of fifteen years in the lap of old Mother Agriculture. * *

Machine-farming developments from 1850 to 1920 have released approximately 27,000,000 workers from agriculture. Picture the undeveloped state of our cities, industries, transportation, and above all the entire absence of our modern sanitary and labor-freeing homes if we were still required to produce our agricultural crops as we did one hundred years ago. It takes but little imagination to picture our now beautiful country with its marvelous beautiful cities, as a peasant country, ground down under long hours of toil, poorly educated people, faced periodically with famine and pestilence, with simple labor-killing homes for our families to live in, if farming were now carried on as it was in 1830. * *

While our population in 1950 may be six times as great as in 1850, yet it is conceivable and probable that the decrease in number of farm workers which started to take place in 1910 will continue, and by 1950 no more farm workers will be required to supply food for a population of 150,000,000 than were required in 1850 for a population of 25,000,000. What does it mean to a country to have millions of its workers freed from agricultural pursuits? It means better homes, higher standards of living, lessened hours of labor, better health, and more happiness. * *

If the present total crops of the United States could be produced under conditions where the average man-hours per unit of production were even twice those of efficient production with mechanical power, less than one-half of our agricultural workers would be required in agriculture.

These quotations from competent authorities afford an explanation of why production has not fallen off with the decline of farm population, and give a warning against expecting too much from legislation. An economic development such as is indicated cannot be stopped. If the advantages of motor-drawn machinery are as described, the farmers who adopt it will prosper at present prices for farm products, and those who do not adopt the system will be under increasing pressure from the competition, despite anything that can be done for them. In the long run the most economical methods will prevail in all lines of industry and business, and this is as it should be, because it is the way of progress and serves the general welfare.

The immediate effects of improved machinery are in reducing the labor costs of the crops, rather than in increasing production per acre, and unless acreage is increased the new machines may have comparatively little effect upon aggregate production or prices. It is pertinent to say this, that the influence in this respect may not be exaggerated. The area of unoccupied land in this country readily available for cultivation is comparatively small, al-

*HARVEY BAUM; A study of the Agricultural Revolution, University of Pennsylvania Press, Philadelphia.

*Professor Stewart was associate professor of Agricultural Engineering in the University of Minnesota for eight years, but resigned recently to accept the position of president of the Northwestern Public Utilities, Inc.

though there is much that may be brought under cultivation by means of capital outlay for clearing, drainage or irrigation.

It seems to be evident that for agriculture itself to benefit from the increasing productive capacity of the farm workers, the surplus of such labor should find employment in other industries, rather than that farm acreage shall be enlarged. Against this movement, however, from the farms to the cities, the leaders of the farm relief movement have been resolutely opposed.

A hopeful feature of the situation is the developing promise of increased utilization of farm products as raw materials in other industries, as in the case of corn stalks for wall-board, paper, etc. A new era in many industries has opened with the development of cellulose products, and corn stalks contain a cheaply available supply of cellulose. The news dispatches from Washington have told of a recent visit by representatives of the farm organizations upon President Coolidge, to urge an increased appropriation for research work by the Department of Agriculture, to develop new uses for farm products. Judicious expenditures of this kind seem to afford the greatest promise of practical farm relief.

Valuation of Railroad Property

It has been apparent for some time that an important issue was arising over the official valuation of railroad property for rate-making purposes, and likewise as to the valuation of all public utilities. Shall charges be fixed with a view to producing fair returns on a 1914 valuation, or on a valuation made at the present time, taking account in the latter case of the purchasing power of present income, as shown by reproduction cost of the property at present wages and construction costs?

The issue is but one feature of the general readjustment of wages, prices and property values which has been going on since 1914. It is a familiar fact that when a change in the general price level occurs all commodities and services are not immediately affected in the same degree. Under the control of dominant conditions, such as supply and demand, custom, contractural relations, official regulation, etc., some services are adjusted to a new level less rapidly than others. The pay of employes in the various public services, national, state and municipal, of school teachers, judges of the courts, members of Congress, etc., was not promptly raised to correspond with the rise of the general price level, but has been gradually advanced in response to the argument that the increase in the compensation of the other groups and the resulting rise in the cost of living had the effect of reducing the real compensation of all groups whose pay was not advanced in corresponding degree. The argument is unanswerable. When the general price situation changes rapidly and unevenly it is by the pressure of abnormal conditions, making extraordinary demands for services in certain lines, and rising wages and prices in those lines tend to effect the readjustment which at the moment is required. When the pressure is relaxed an inevitable tendency sets in for the restoration of the former relationships, and it is right that this should be so.

The Theory of Public Regulation of Charges

The rates charged by public utilities, including railroads, are regulated by public commissions upon the theory that the utilities are "affected with a public interest," and, therefore, subject to governmental supervision; and this right to regulate is further justified by the monopolistic character of most public utilities. However, the laws of the land, in conformity with the constitution of the United States, provide that official regulation shall allow a fair return upon the reasonable value of the property employed for public use.

It should be clearly understood that this provision of law does not guarantee earnings. The Esch-Cummins law has been much misrepresented in this respect. If capital is unwisely invested, or if conditions change to such an extent that a property cannot earn profits, as has been the case with many railroad and public utility companies, the capital is sunk. These are business risks which the investors must bear. They must also accept regulation of charges for the purpose of restricting earnings to a fair return upon the value of the property, but beyond this the regulating commissions are not authorized to go.

There remains the question of what is a "fair and reasonable" return. This is first determined by the legislative or regulatory bodies, but subject to review by the courts, whose function it is to interpret such general expressions in the laws and the constitution. The courts have held uniformly that it is the usual return which capital is able to earn at the time under free conditions; which practically means a return sufficient to induce capital to flow into the regulated employments in competition with other investments, and in sufficient volume to meet the public needs. This policy has been held to be in the public interest, because private investors would not place their capital in public service companies unless they might expect to do as well with it there as elsewhere. The return which the law contemplates, therefore, is not one fixed arbitrarily or absolutely, but one conforming to the general market value of capital.

The Question of Valuation

Thus a fair and reasonable return depends not only on the current market rate for capital but upon the official valuation placed upon the

property. The capital invested in public service enterprises exists in the form of real estate, buildings, machinery, equipment, inventories, etc., all of which have a replacement value determined by present prices and construction costs. Similar property in the free industrial field has undergone an enhancement in money value generally corresponding to the rise of prices and costs. It is a natural and inevitable readjustment between properties constructed before the war and since, for there cannot permanently be different values for properties having the same utility.

Moreover, such a change in nominal valuation does not signify a change in actual value or earning power from that which existed before the general change of prices occurred. It is a readjustment conforming to the general change in money values. A money income at the pre-war rate on a pre-war valuation obviously does not yield as much purchasing power as it did before the war. The party receiving it is not in the same position he was before; his position has been changed for the worse.

Of course no question is raised over the valuation of newly constructed railroad property. A new railroad may earn (if it can) a fair return on the actual investment at present costs. The issue relates only to the valuation of railroad property which although just as valuable in every other sense, was constructed when money costs were lower, and to the further question whether the same charges may be made for the use of the latter property as for the former. In short, the question is whether the readjustments in capital valuations and current returns which are taking place naturally as to other kinds of property and services shall be permitted to take place as to railroad property and services.

Judicial Precedents

The rule of the courts, as held in a long line of decisions, has been that in determining the investment upon which a public utility is entitled to a fair return, due consideration shall be given the present value of the property usefully employed in the public service, whether this value be more or less than the original cost. This rule has been applied in cases where the property in question was shown to have declined in value, as well as in cases where it had increased in value. Thus in San Diego Land and Town Company v. National City (74 Fed. 79), the United States Circuit Court, May 4, 1896, a time when prices and construction costs were lower than they had been, Judge Ross declined to enjoin the municipality from enforcing an ordinance reducing a water rate. He said upon the question of the value of the property:

> In the solution of that problem many considerations may enter; among them, the amount of money actually invested. But that is by no means, of itself, controlling, even where the property was at the time fairly worth its cost. If it has since enhanced in value, those who invested their money in it, like others who invest their money in any other kind of property, are justly entitled to the benefit of the increased value. If, on the other hand, the property has decreased in value, it is but right that those who invested their money in it, and took the chances of an increase in value, should bear the burden of the decrease.

This opinion sets forth the reciprocity of rights which is the essence of justice in such cases. This decision was affirmed by the Supreme Court of the United States, Justice Harlan writing the opinion (174 U. S. 739). The same question was involved in San Diego Land and Town Company v. Jasper, decided on the same principles by Judge Ross in 1901 and affirmed by the Supreme Court in an opinion written by Justice Holmes (189 P. S. 439). In his opinion, dated April 6, 1903, Justice Holmes reaffirmed the doctrine laid down in the earlier case, that "What the company is entitled to demand, in order that it may have just compensation, is the reasonable value of the property at the time it is being used by the public."

One of the early cases on the subject, but still recognized as a leading case, is Smythe v. Ames, decided by the Supreme Court of the United States March 7, 1898 (169 U. S. 466), in which the opinion was written by Justice Harlan. He named as elements in determining value, the original cost of construction, the present, as compared with the original, cost of construction, together with other factors, and added:

> We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth.

Bluefield Waterworks & Imp. Co. v. Public Service Commission of West Virginia is a comparatively recent case (262 U. S. 679), in which the Supreme Court quoted and based its decision in part upon the following precedent opinions:

> There must be a fair return upon the reasonable value of the property at the time it is being used for the public. And we concur with the court below in holding that the value of the property is to be determined as of the time when the inquiry is made regarding the rates. If the property, which legally enters into the consideration of the question of rates, has increased in value since it was acquired, the company is entitled to the benefit of such increase.—Willcox v. Consolidated Gas Co., 212 U. S., 19, 41, 52. The making of a just return for the use of the property involves the recognition of its fair value if it be more than its cost. The property is held in private ownership and it is that property, and not the original cost of it, of which the owner may not be deprived without due process of law—Minnesota Rate Cases, 230 U. S., 352, 454.

The Southwestern Bell Telephone Company v. Public Service Commission of Missouri is another notable case, decided by the Supreme

Court in 1923 (262 U. S. 276). The chief question involved was whether that part of the company's property which had been constructed prior to 1915, or before the era of higher prices for materials and labor, should be valued according to its cost as determined by the Commission in earlier appraisals or according to cost of reproduction, new, less depreciation, on June 30, 1919, the date on which the Commission had directed the company to show cause why its rates should not be reduced. The Supreme Court of the United States overruled the Commission and the State courts, holding—

> It is impossible to ascertain what will amount to a fair return upon properties devoted to public service without giving consideration to the cost of labor, supplies, etc., at the time the investigation is made.

One of the most recent decisions of the Supreme Court on the subject is upon McCardle et al., as members of the Public Service Commission of Indiana, et al., v. Indianapolis Water Company, decided November 22, 1926 (272 U. S. 400). Following is an extract from the opinion of the Court:

> Undoubtedly, the reasonable cost of a system of waterworks, well planned and efficient for the public service, is good evidence of its value at the time of construction, and such actual cost will continue fairly well to measure the amount to be attributed to the physical elements of the property so long as there is no change in the level of applicable prices, and, as indicated by the report of the Commission, it is true that, if the tendency or trend of prices is not definitely upward or downward and it does not appear probable that there will be a substantial change of prices, then the present value of lands plus the present cost of constructing the plant, less depreciation, if any, is a fair measure of the value of the physical elements of the property. The validity of the rates in question depends upon property value January 1, 1924, and for a reasonable time following. While the values of such property do not vary with frequent minor fluctuations in the prices of material and labor required to produce them, they are affected by and generally follow the relatively permanent levels and trends of such prices.

The St. Louis & O'Fallon Railway Case

In view of the decisions referred to above, it was inevitable that the question therein passed upon would be raised in the valuation of the railroads by the Interstate Commerce Commission, and ultimately go to the Supreme Court. It has now reached that tribunal in a case brought by the Commission, under what is known as the "recapture" clause of the Transportation Act of 1920, against the St. Louis & O'Fallon Railway Company, alleging that certain payments are due from that company to the general railway contingent fund, on account of earnings in excess of 6 per cent upon the value of that company's property.

The Commission has been engaged for many years upon the task of valuing the railroads, but although far advanced it has not yet reached the stage as to many companies where action to compel a division of surplus earnings is practicable. The St. Louis & O'Fallon railway is a coal road only nine miles long, of which the Commission, in its decision of the case, rendered 1927, has said that "the completeness and satisfactory character of all the evidence in this record regarding the value of the property" makes it practicable to determine the value for rate-making purposes as of the dates in question. It accordingly makes the claim for a division of surplus profits and sets forth its theory of valuation.

Decision of Interstate Commerce Commission

The Commission adopted the policy of valuing the property on the basis of 1914 costs and as the company showed earnings of more than 6 per cent on the valuation so obtained, the Commission made claim for a division of the surplus, and laid down its theory of valuation. From this decision the railway company took an appeal to the United States District Court for the Eastern District of Missouri, which rendered a decision supporting the Commission, from which an appeal was taken to the Supreme Court of the United States, which has set the case for hearing in January, 1929.

The Commission divided upon the decision, six members comprising the majority and four signing dissenting reports. The majority defended the valuation on the 1914 basis of reproduction costs for construction work, with common-carrier lands valued at "the fair average of the normal market value" of lands adjoining and adjacent as of valuation date. Its argument against revaluation upon the basis of reproduction new at present costs naturally does not directly take issue with the Supreme Court rulings indicated above, but emphasizes references in the opinions to other elements of value and to the exercise of a "reasonable judgment having its basis in a proper consideration of all relevant facts". It gives at the outset clear recognition of the fundamental truth that private capital invested in railroads must receive treatment which attracts and encourages further investment, saying:

> The end in view, as we have stated, is the maintenance of an adequate national railway transportation system. Such a system, so long as it is privately owned, obviously can not be provided and maintained without a continuous inflow of capital. Obviously, also, such an inflow of capital can only be assured by treatment of capital already invested which will invite and encourage further investment. We think it must be conceded that under a system of public regulation which produces such a result private property can not be confiscated. Confiscation is a taking of property without just compensation. It is idle to contend that treatment of private property which attracts and encourages further capital ventures can be confiscatory. Furthermore, public regulation of railroads which is to any considerable degree more liberal to the private owners than is necessary to maintain good credit under reasonably prudent, economical, and efficient management can not be justified.

From this it proceeds with an argument to the effect that violent changes in the rate base are impracticable, as injurious to the general

prosperity and thus to the railroads themselves. It pronounces the fluctuations in the price-level which have occurred since 1920 as too violent to admit of prompt adjustment of capital valuations thereto. It argues for stability of values and in behalf of latitude for the Commission in dealing with the subject of a fair return, saying:

Whatever the rate base, we are enjoined and required to so adjust the "fair return" that investment in railroad facilities will be encouraged and promoted and the companies maintained in good credit. If this end be accomplished, there can, in our opinion, be no confiscation. Moreover, adjustments in "fair return" necessary to accomplish this purpose can be made much more readily and with greater justice to all concerned than adjustments in "value." The prime requisites for the rate base, as we think we have made clear, are stability, reliability, and relative ease of adjustment to property changes.

It says that since the price revolution brought about by the war, the railroads "have not had nor have they sought returns based upon 'values' swollen in harmony with the general price level;" furthermore, that the roads have not obtained the "fair return" named by the Commission and which the established rates were intended to yield, thus implying that a higher valuation of the property would not help their situation. It takes the position that the railroads generally have acquiesced in the view of the Commission, that a higher return upon the investment was impracticable, realizing that to seek higher returns "would be to risk conflict with inexorable economic conditions." It cites the acceptance of lower rates by the companies in 1922, and in referring to the small advance of rates asked by the western roads and denied in 1926, says that the companies asked only that their recorded investment be used as a base, conceding that "traffic probably could not bear rates based on any higher amount."

This part of the argument proceeds to the conclusion that under the policy of the Commission, the finances of the railroads have greatly improved since 1920, that the investment in railroad property has increased $4,000,000,000 in that time, that with exceptions in certain sections of the country, "the railroads are now in better credit and financial condition, in all probability, than at any time in their history." It adds the statement, pertinent for several reasons, that the "standard of service is clearly better than ever before."

The trend of the majority argument is to the effect that the railroads are generally prosperous and in good credit, that they are able to obtain the new capital required by their necessities and development, hence that the essential end in view, above stated, "the maintenance of an adequate national transportation system" is being adequately safeguarded.

The Dissenting Opinions

The main dissenting opinion, written by Commissioner Hall and joined in by Commissioners Aitchison, Woodlock and Taylor, is based upon Supreme Court decisions, which they accepted as laying down the principles of the law unmistakably. It says that under the law the Commission is bound to accord weight in the legal sense to the greatly enhanced costs of material, labor and supplies during the periods of inquiry, over those prevailing at the year of valuation (1914). It points out that in previous utterances of the Commission statements have indicated that although values had been determined as of one and the same date, June 30, 1914, corrective factors would be applied, "as the normal trend of prices may go upward or downward."

Commissioner Woodlock, in an individual dissenting opinion, expressed his view as follows:

With the majority's main arguments of an economic nature I am in fundamental disagreement. The contention that stability of the investment in railroad property is best attainable by irrevocably linking that investment to the dollar seems to be on its face quite untenable. The dollar is valuable only because of the commodities that it will buy. Its purchasing power is notoriously characterized by great and continuous instability. The investment theory of value urged by the majority equates railroad property with the dollar. The principle of valuation expressed in the decisions of the Supreme Court equates railroad property with all other forms of property. This is the only real and effective stabilization. For the majority's theory to produce effective stabilization of railroad property it would be necessary, first, to stabilize the dollar. Who is there who does not know that his dollar to-day buys him a good deal less of food, fuel, clothing, and shelter than it did in 1914? This it is which constitutes what I must call the basic unfairness of the majority's proposal to stamp the greater part of railroad property in existence to-day with the dollar relation of 1914, thus saddling perpetually upon the owners of that property the loss inherent in the depreciation of the dollar since that time. * * *

The main purpose of regulation of public utility enterprises is to supply to the public that protection in the matter of rates, fares, and service which is supplied in the mass of freely competitive—and, therefore, unregulated—enterprises by the force and play of competition. In fully competitive enterprises the rate of return tends at all times to circle around the point where it will just suffice to attract capital into the industry when and as needed. This being so, it follows that railroad rates and fares should, under regulation, be so adjusted that the return offered will tend to be **high enough** to attract the investor's capital—and **no higher.** If it be true—and it is true—that value and fair return must be so reciprocally adjusted as to attract capital to the railroad industry, as it is needed, and the rates and fares are to be made just high enough to produce that result, and no higher, why can not that adjustment be made with values found as the Supreme Court indicates that they should be found?

Commissioner Woodlock touches upon that part of the majority opinion which claims support for its argument in the facts that capital is being obtained for the railroads freely and that the service of the roads is better than ever before, commenting as follows:

Furthermore, it seems to me that if any conclusion may fairly be drawn from the fact that capital has been supplied to the railroad industry by investors

in the years following 1920, it is the conclusion that in supplying it investors have relied upon the terms of the law, the statements of this commission, and the decisions of the Supreme Court, all of which are now summarily set aside by the majority.

Commissioner Taylor dissents in an opinion which definitely challenges the main thesis of the majority opinion, to wit, that revaluation would result in a very great change of rates. He calls attention to the fact that the capital charge upon railway traffic is small in comparison with the operating charge, which already has been increased to cover the higher costs of labor, fuel, equipment, etc. He says:

The proportion of labor, material, and taxes for all class I railroads of the United States for the last year for which the record is completed amounted to practically 82 per cent of the total disbursements out of operating revenues for these costs and for interest and dividends.

Since the year 1914 the tremendous increase in the cost of labor and material, which form the body of railroad operating expense, and the additions to tax burdens, have made necessary a weighted advance in the rates for transporting passengers and freight, which has been approved by this commission, of approximately 50 per cent. * * *

As it has been necessary, in the maintenance of an adequate system of transportation, to permit such a large increase in the passenger and freight rates since 1914, necessary to provide for the present-day scale of labor and material included in the operating cost, and the current tax levy, which may be referred to, generally speaking, as the burden of operation, and which represent 82 per cent of the total of these disbursements out of operating revenue, why should we treat in a different manner, or rest upon another basis of value, the 18 per cent of these disbursements out of the same revenue, necessary to bear what may be referred to, generally speaking, as the burden of ownership?

A determination of the value of this property as it exists to-day will not require a further great increase in rates for transportation, because these rates are now adjusted to bear present-day costs of operation and maintenance, and, generally speaking, would need only to be slightly increased to yield 5¾ per cent on present-day cost of reproduction, if that were found to be the fair rate of return under the circumstances.

The Main Issue

The main question is obscured by the great difficulty which many persons have in grasping the fact that the same money valuation or return may have very different practical values at different times. The railway employes grasp it readily when their pay is involved. They know there is a legitimate reason why their services should be rated higher than in 1914, and no very general opposition has been made to an advance of more than 100 per cent. The argument for this advance has been that values in terms of money have changed since 1914, that rents, food, clothing and all the expenses which the employes must meet have advanced, and that they must have more income in order to maintain the same relative position which they occupied in 1914. This likewise is true of the values entering into railroad property and affecting the individuals who own the railroads and supply the railroad service. The fact that the railroads were built prior to 1914 has no more bearing than the fact that the railroad employes of today were born prior to 1914. The service of the employes and the service of the railroads are alike rendered now and paid for in money of present purchasing power. The pay in each case should be judged by the general scale of pay and prices at the present time.

Every group in the community wants to maintain its relative position with the others, and in the competitive field this is fairly well achieved, but where the pay of services is supervised by public authority the consent of that authority to such a readjustment is necessary. The courts had dealt with the question on general principles long before 1914. Their finding was that a rise or fall of general prices affected the value of the property under consideration, because the physical elements entering into it, and consequently the cost of reproduction at the time, would be similarly affected. The reasoning is logical and the effect of the ruling is to place investors in this kind of property on the same basis as investors in the competitive industries, which is the general rule of public control.

The action of the courts is not based upon any theory of general governmental price-fixing, but simply upon the principle that where the legislative authority undertakes to regulate the compensation of certain classes of corporations it must do so upon a just basis.

Reproduction cost is by no means the only element entering into the valuation of railroads and other public utilities. "Going value," or in other words the value which attaches to the fact that an industrial concern has an established business and is operating successfully, has been recognized. The opinion of Justice Harlan, as quoted above, shows the attitude of the courts toward all factors which may have bearing. Want of space forbids our making additional quotations.

The Rule Works Both Ways

It is essential to observe that the rule which the Supreme Court has applied works both ways, as shown in the San Diego case referred to above, and that valuations based upon investments at war time costs may be reduced when reproduction costs have fallen. This is just what occurs throughout competitive industry. The effects of the war-time rise of prices and subsequent decline have been felt in agriculture, manufacturing, mining, everywhere, and it may be doubted if they can be escaped anywhere. The possibility of loss to investors by revaluation on a declining price level was emphasized by Justice Brandeis in a dissenting opinion in the Southwestern Bell Telephone case, and made the basis of an argument for "historic value" or "prudent investment value" instead of present investment value. This argument is similar to the Commission's argument for stability of values, but

it would seem to raise the question as to how stability of value can be assured to any kind of physical property in view of the constant changes being made in industry. A good many investors in inter-urban electric railways would like to know how the "historic" or "prudent investment" value can be restored to their properties. There are difficulties under any arbitrary rule for the public regulation of returns on private investments, but the rule which has been favored by the Supreme Court has the merit of working both ways, and in harmony with the workings of the economic law in the competitive field.

Change in Financial Status Since 1920

That the railroads now are in far better condition financially than in 1920 is unquestionably true. They were almost in a general state of bankruptcy then. The transportation act of 1920 was designed to help the credit of the railroads and had that effect. The courage, enterprise and ability which the railroad managements have shown in borrowing money and using it for the reduction of operating costs has been a factor in the improvement of the situation which should not be overlooked. It is something to their credit that they have been able to meet an increase of over 100 per cent in wage rates and prices of supplies by the aid of a 50 per cent increase in freight rates. The most important factor, however, in the decline of interest rates on railroad borrowing has been the general reduction of interest rates in the money market, due to the increased amount of capital seeking investment. It is well upon each occasion when some new proposal for curtailing capital earnings is up for consideration to call attention to the general benefits resulting from capital accumulation.

It should be observed in this connection that the attitude of the Commission upon valuation has not been unfavorable to new capital invested in railroad property during the period of high construction costs. These investments are valued at full cost, as of course they would have to be if new investments in railroad property were not to cease. The protest is that the Commission refuses to allow equal values to properties which actually possess equal values, tested either by service rendered, earning power or reproduction cost.

It is important also to note that with few exceptions the new capital which has been raised for railroads since 1920 has been raised by borrowing, thus creating claims upon the earnings which rank ahead of the capital stock. So long as there is a reasonable margin of proprietor's capital to safeguard the debt-holders, the ability of the companies to sell bonds is not convincing evidence of railroad prosperity, but in the long run this margin of proprietor's capital is necessary to maintain railroad credit.

Probable Effects of Higher Valuation

Commissioner Taylor, in his dissenting opinion, quoted above, has to a great extent disposed of the exaggerated estimates of the increase in charges which would result from a decision by the Supreme Court in line with its past rulings. The proportion of gross revenue which in any case goes to railroad capital is relatively small. The general price-level has been declining and is likely to continue declining in the future, and this is especially so of construction costs. Furthermore, this decline will not only lower the replacement value of the railways but their general operating expenses, so that any increase in the capital charge probably would be offset by decreases in their present outlays.

Moreover, the majority opinion bears testimony to the policy of the railroad managements in regard to rate increases where the volume of traffic is likely to be unfavorably affected. The acceptance of a rate reduction upon agricultural products in 1922 is a case very much in point. The railroads are interested not only in the movement of agricultural products out of a section but in the return movement of commodities into the same section. They are very much interested in promoting an increasing volume of traffic, because it is by this policy that the largest net income is obtained. If traffic cannot earn a compensatory rate, and net earnings will be reduced by imposing such a rate, ordinary business policy will induce the acceptance of a lower rate, even though such action involves the conclusion that a part or all of the invested capital is hopelessly sunk. Such a case, however, signifies only an inevitable loss, and not a sacrifice of constitutional rights.

That no very radical changes would result from a railroad victory in the pending case is indicated by experience under the transportation act of 1920. This act instructs the Commission to adjust rates to allow the carriers to make earnings at what the Commission might determine to be a fair return upon the Commission's estimate of the aggregate value of railroad property, but although the act was passed eight years ago the majority opinion frankly states that the roads have not received such return.

Finally, it is to be considered that while it is for the Supreme Court to lay down the rule of valuation and the principles of fair compensation, the terms of its findings inevitably will allow considerable latitude to administration, which will be subject to regulation by Congress and its agency, the Interstate Commerce Commission.